Supreme Court, U.S.
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No. 92-1370

In the Supreme Court of the United States

OCTOBER TERM, 1992

BFP, PETITIONER

v.

RESOLUTION TRUST CORPORATION, AS RECEIVER FOR IMPERIAL FEDERAL SAVINGS ASSOCIATION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENT

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QUESTION PRESENTED

Whether the consideration received from a noncollusive foreclosure sale that is conducted in conformance with applicable state law constitutes "reasonably equivalent value" under 11 U.S.C. 548(a)(2)(A).

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-23) is reported at 974 F.2d 1144. The opinion of the bankruptcy appellate panel (Pet. App. 49-68) is reported at 132 B.R. 748. The opinions of the district court (Pet. App. 41-43, 44-48) and the bankruptcy court (Pet. App. 33-40) are unreported.

JURISDICTION

The judgment of the court of appeals (Pet. App. 24-25) was entered on September 8, 1992. A petition for rehearing was denied on November 17, 1992. Pet. App. 26-27. The petition for a writ of certiorari was filed on February 16, 1993 (a Tuesday following a Monday

holiday). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. On August 27, 1987, Sheldon and Ann Foreman conveyed the real property at issue in this case to Wayne and Marlene Pedersen, who on the same day conveyed the property to petitioner (a partnership in which the partners were the Pedersens and Russell Barton). Petitioner received title subject to a first lien in favor of Imperial Savings and Loan Association, to secure payment of a loan of $356,250 made to the Pedersens to enable them to purchase the property. When petitioner failed to make timely payments on the loan, Imperial commenced foreclosure proceedings under state law. The foreclosure proceedings eventually were completed at a foreclosure sale on July 12, 1989, at which respondent Paul Osborne purchased the property for $433,000. Pet. App. 3-7.

2. Petitioner then filed for bankruptcy. In the bankruptcy case, petitioner instituted an adversary proceeding attempting to set aside the conveyance of the property to Osborne at the foreclosure sale; petitioner argued that the sale was a fraudulent conveyance that the bankruptcy court was empowered to avoid under 11 U.S.C. 548(a)(2). The bankruptcy court granted summary judgment against petitioner. Pet. App. 33-40. The court explained that the sale could not be avoided, reasoning that "a reasonably equivalent value was received in exchange for the transfer, because the nonjudicial foreclosure sale was noncollusive and regularly conducted." *Id.* at 39; see 11 U.S.C. 548(a)(2)(A) (permitting avoidance of a transfer

only if the debtor "received less than a reasonably equivalent value in exchange for such transfer").

3. The district court affirmed in a short order explaining that "the court below has ascertained and applied the existing law of this Circuit correctly in reaching its legal conclusions and its decision." Pet. App. 41-43.

4. The bankruptcy appellate panel affirmed. Pet. App. 49-68. Applying the analysis of its decision in *In re Madrid*, 21 B.R. 424 (Bankr. 1982), the panel stated that

> [a] non-collusive and regularly conducted nonjudicial foreclosure sale prior to the filing of a bankruptcy case cannot be challenged as a fraudulent conveyance because the consideration received in such a sale establishes "reasonably equivalent value" as a matter of law.

Pet. App. 54-55. The panel then rejected petitioner's claims that the sale in this case was not regularly conducted. *Id.* at 56-59.[1]

5. The court of appeals affirmed. Pet. App. 1-23.[2] Viewing the issue as "a close one," the court adopted the view of the Sixth Circuit that the consideration

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[1] Bankruptcy Judge Volinn dissented. Pet. App. 60-68. He argued that the panel should adopt the reasoning articulated by the Seventh Circuit in *Bundles* v. *Baker* (*In re Bundles*), 856 F.2d 815, 820 (1988), under which there is a rebuttable presumption that the price obtained at a noncollusive foreclosure sale constitutes reasonably equivalent value.

[2] Before the court of appeals rendered its decision, the Resolution Trust Corporation was appointed receiver of Imperial Federal Savings Association, the successor in interest to Imperial Savings and Loan Association.

received at a noncollusive regularly conducted foreclosure sale constituted reasonably equivalent value under Section 548(a)(2)(A). Pet. App. 17-18 (citing *In re Winshall Settlor's Trust*, 758 F.2d 1136, 1139 (6th Cir. 1985)). The court explained that it "necessarily part[ed] from the positions taken by the Fifth Circuit in *Durrett*[v. *Washington National Insurance Co.*, 621 F.2d 201 (5th Cir. 1980)], and the Seventh Circuit in *Bundles*[v. *Baker* (*In re Bundles*), 856 F.2d 815, 820 (1988)]." Pet. App. 18-19. The court explained that "allowing a bankruptcy court to undo a foreclosure sale carries with it the strong potential to destabilize state mortgage transactions" and that it viewed that result as

> untenable from both federal and state perspectives. From a state viewpoint, an ad hoc approach produces intolerable uncertainty regarding the finality of any purchase at a foreclosure sale even if the price paid at the sale is close to, but not equal to, the retail market value. From a federal perspective, this uncertainty undermines the price-maximizing objectives of section 548(a)(2) because potential buyers will discount their assessment of the true market value of the property to reflect this uncertainty.

Id. at 20-21 (internal quotation marks omitted). Noting this Court's admonition that "interpretation of federal statutes should be tempered with due regard for traditional state areas of regulation," *id.* at 22 (citing *Cipollone* v. *Liggett Group, Inc.*, 112 S. Ct. 2608, 2617-2618 (1992)), the court held that the price received at a noncollusive, regularly conducted foreclosure sale establishes reasonably equivalent value for purposes of Section 548(a)(2)(A).

DISCUSSION

Petitioner argues that the court of appeals erred in holding that the price received at a noncollusive regularly conducted foreclosure sale constitutes "reasonably equivalent value" for purposes of 11 U.S.C. 548(a)(2). We believe the court of appeals was correct, but because other courts of appeals have reached contrary results on the question, it would be appropriate for the Court to grant the petition.

1. Section 548(a)(2) of the Bankruptcy Code, 11 U.S.C. 548(a)(2), grants trustees in bankruptcy the power to avoid certain transfers made "within one year before the date of the filing of the petition," if the debtor "received less than a reasonably equivalent value in exchange for such transfer or obligation." 11 U.S.C. 548(a)(2)(A). Petitioner contends that a debtor whose property has been sold at a public foreclosure sale that conformed in every way to the requirements for such a sale under applicable state law subsequently can reclaim the property by arguing that the price received at the public auction was not "reasonably equivalent" to the value of the property. We do not agree.

The price received at the foreclosure sale is the best available evidence as to a "reasonably equivalent" value for the property. The foreclosure sale is a public auction at which any party who wishes to do so is free to bid, and is conducted in accordance with the procedures prescribed by state law for the liquidation of debts against real property. To allow a debtor to attempt to prove in court months later that the

collateral at the time of the sale had a value that neither the debtor nor any other party was willing to pay at the time of the sale turns any reasonable notion of value on its head.[3]

Moreover, a rule allowing federal bankruptcy courts to overturn foreclosure sales conducted in accordance with state law fails to take account of this Court's perception that the Bankruptcy Code generally displays a consistent respect for the rules of state property law, which Congress generally has allowed to remain in force except where "some federal interest requires a different result." *Butner* v. *United States*, 440 U.S. 48, 55 (1979); see *ibid.* (courts should avoid granting "a windfall merely by reason of the happenstance of bankruptcy") (internal quotation marks omitted). As the Court has explained, "[w]e do not read these statutory words with the ease of a computer," but must allow notions of "our federalism * * * [to] influence our interpretation of the Bankruptcy Code." *Kelly* v. *Robinson*, 479 U.S. 36, 49

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[3] On this point, it is important to note that the statute in question refers not to "fair market" value—as the Code does elsewhere, *e.g.*, 11 U.S.C. 522(a)(2)—but to "reasonably equivalent" value. By rejecting the concept of "fair market value"—which would have indicated the value the property would have brought in a transaction between a willing buyer and a willing seller, neither being under any compulsion to buy or sell—Congress necessarily required courts to accept transactions that brought a lesser value, provided that the lesser value was "reasonably equivalent." In our view, the concept of reasonableness in this area must account for the consideration that the debtor's failure to satisfy its financial obligations has made a prompt liquidation of the property necessary to satisfy the creditor's contractual right to repayment.

(1986) (internal quotation marks omitted). A rule allowing federal courts to overturn foreclosure sales that are conducted in accordance with state law does not afford sufficient weight to the State's legitimate interest in promulgating norms for the creation and enforcement of interests in real property.

Finally, a contrary rule would undermine the stability that benefits both debtors and creditors, inside and outside of bankruptcy proceedings. The rule sought by petitioner would lead to the result that no purchaser at a foreclosure sale could be sure that it had received clear title to the property, no matter what it paid. That result necessarily would give individuals considering a purchase at a foreclosure sale an incentive to bid less than they otherwise would, an incentive that ineluctably leads to lower revenues for debtors and hence less funds with which to repay the debts owed other creditors.

The Bankruptcy Code does not prescribe a method for federal courts to use in determining what is a "reasonably equivalent" value, and thus does not by its terms require federal courts to overturn the mechanisms established under state law for placing a value upon collateral at foreclosure. In light of our country's long tradition of state-law preeminence in crafting rules for the creation and enforcement of interests in real property, this should be no surprise. Given the importance of stability and predictability in commercial transactions, the most reliable method for ascertaining the "reasonably equivalent" value in this context is to rely on the value obtained at a public auction conducted in accordance with state law. The court of appeals correctly adopted that method.

2. Petitioner correctly states that the courts of appeals have reached divergent results on the question presented. Pet. 10-14. Two courts of appeals have adopted the position set forth above: the Ninth Circuit in this case and the Sixth Circuit in *In re Winshall Settlor's Trust*, 758 F.2d 1136, 1139-1140 (1985). A second approach was adopted by the Fifth Circuit in *Durrett* v. *Washington National Insurance Co.*, 621 F.2d 201 (1980), under which a foreclosure sale can be overturned if the price is not sufficiently close to the fair market value of the property. See *id.* at 203 (noting that it had found no case that had "approved the transfer for less than 70 percent of the market value of the property"). Finally, the Seventh Circuit in *Bundles* v. *Baker* (*In re Bundles*), 856 F.2d 815 (1988), rejected both of those approaches and adopted what it characterized as a "middle ground" under which "[r]easonable equivalence should depend on all the facts of each case." *Id.* at 824. That rule has been adopted by three other courts of appeals. See *Barrett* v. *Commonwealth Federal Savings and Loan Association*, 939 F.2d 20, 24 (3d Cir. 1991); *Cooper* v. *Ashley Communications, Inc.* (*In re Morris Communications NC, Inc.*), 914 F.2d 458, 466-467 (4th Cir. 1990); *Grissom* v. *Johnson* (*In re Grissom*), 955 F.2d 1440, 1445-1446 (11th Cir. 1992).[4]

[4] The Eighth Circuit also has rejected the Ninth Circuit's approach, although it is not clear whether it follows the *Durrett* approach or the *Bundles* approach. *First Federal Savings & Loan Association* v. *Hulm* (*In re Hulm*), 738 F.2d 323, 327 (8th Cir.), cert. denied, 469 U.S. 990 (1984).

In light of the fact-specific nature of the tests articulated by the Fifth and Seventh Circuits, it is difficult to be certain that this case—or any other case—ultimately would have been decided differently under the rules that prevail in those circuits. It is clear, however, that in those circuits a factual hearing would have been required at which the debtor would have had an opportunity to overturn the foreclosure sale. Under the rule articulated by the Ninth Circuit in this case, the debtor in this case had no such opportunity, and it therefore is probable that panels in the Fifth and Seventh Circuits would have reversed the judgment of the bankruptcy court in this case.

As the number of decisions in the courts of appeals attests, the question presented in the petition recurs with considerable frequency. It also has a significant impact on the bankruptcy cases in which it arises; for example, petitioner alleges that the property at issue here was undervalued by more than a quarter of a million dollars. Pet. 6. Given the pronounced divergence of the analysis of the courts of appeals on the question, it does not appear likely that the lower courts will reach a unanimous view on the question. Accordingly, review by this Court would be appropriate.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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